On slippery ground

The month of May was in focus for the outcome of general elections. In line with the exit polls, the BJP led alliance, NDA, garnered 353 seats, an improvement over the tally of 336 seats in 2014 general election. From an economic standpoint, the election outturn is unambiguously positive as a stable government formation will ensure policy continuation with limited room for political distractions. The full majority gives NDA government a significant political capital. It also reinforces the belief in some of the policies undertaken during their last term; particularly the actions to keep the inflation contained and focus on social security net.

On the global front, the US and China trade negotiations stumbled yet again. The US threatened China with a fresh levy of 25% on Chinese goods import worth at least USD 300 bn and an increased levy from 10% to 25% on imports worth USD 200 bn. The tensions got exaggerated further with the US declaring a ban on Chinese telecommunications giant Huawei Technologies Co. In retaliation, China raised duties on US imports, levied fines on a few US companies for antitrust violations in China and issued an advisory for its citizens against travel to the US. Adding to the uncertainty, another unexpected blow came from the proposed US tariffs on imports from Mexico, US's second largest trading partner last year. US had announced a levy of 5% tariffs on all imports from Mexico, starting 10 June, in a move to instigate Mexico to take actions against illegal immigration into the US. The tariffs, which finally got averted, was supposed to be incrementally increased until they reach 25% on 1 October.

Across the Atlantic, another dimension of uncertainty stemmed from the Brexit and the European elections during 23-26 May. After failing to deliver on Brexit, PM Theresa May had resigned last month. Reportedly, the UK's conservative party is likely to choose a new prime minister by end July. At the European parliamentary elections, while Pro-European parties won however their seat share was limited due to gains secured by Eurosceptic opponents.

Amidst these concerns, oil market volatility has continued to swerve the markets. US sanctions on Iran and Venezuela, removal of waivers by the US on imports from Iran, volatility of US crude inventories, Middle East tensions and US-China trade tensions have heightened concerns about further slowdown in the global economic growth momentum and in turn the global oil demand.

With worsening of global economic growth outlook, major central banks including the US Federal Reserve have turned cautious. Recently, the US Fed acknowledged growing risks due to trade tensions and indicated a likelihood of easing rates in case global economic conditions worsen any further. Citing similar reasons, OECD trimmed its global growth forecast to 3.2% for 2019 (earlier forecast released in March: 3.3%), down from 3.5% growth registered last year.

Shubhada M. Rao
Chief Economist

Vineet Dhar
Group President and Head,
Wealth & Channel Management

Global Macro Developments

- US Commerce department imposed duties of more than 400% on steel imports from Vietnam and threatened to impose additional tariffs on EU.
- US Federal Reserve kept rates unchanged in its policy meeting and said that it is ready to cut interest rates as early as next month to battle growing global and domestic economic risks.
- PBoC injected CNY 200 bn to financial institutions via its one year medium term lending facility, with the interest rates unchanged at 3.30%.
- Senior BoE (Bank of England) official said that the bank might need to cut rates to zero from 0.75% at present in an event of a no-deal Brexit, while repeated Brexit delays could make a rate cut necessary.
- Japan's Prime Minister Shinzo Abe is tightening controls on exports of material vital to South Korea's tech industry, shortly after Japanese companies were held liable in a Seoul court for cases of forced labor before and during World War II.
- Japan is not considering raising sales tax beyond 10% for the decade.
- BoJ (Bank of Japan) kept its policy rates on hold. "Downside risks regarding overseas economies are big, so we must carefully watch how they affect Japan's corporate and household sentiment," the BOJ said in a statement.
- US-India trade negotiators reportedly ended talks without any major progress on issues ranging over tariffs and other protectionist measures imposed by both the countries.

Events and Data Calendar

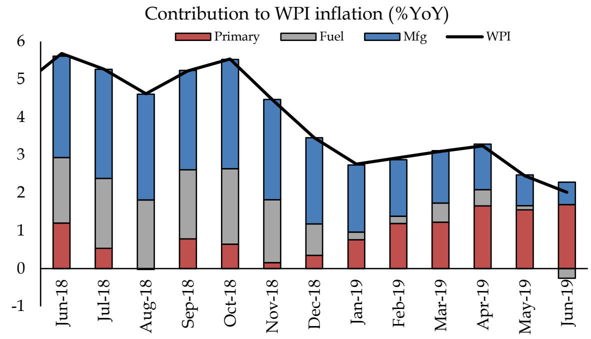
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
UK	19-Jun-2019	CPI YoY	May	2.00%	2.00%	2.10%	⇩
	19-Jun-2019	GDP YoY	1Q F	1.80%	1.80%	1.80%	⇨
	10-Jul-2019	Industrial Production YoY	May	1.20%	0.90%	-1.00%	⇧
US	5-Jul-2019	Unemployment Rate	Jun	3.60%	3.70%	3.60%	⇧
	11-Jul-2019	CPI YoY	Jun	1.60%	1.60%	1.80%	⇩
China	30-Jun-2019	Manufacturing PMI	Jun	49.50	49.40	49.40	⇨
	10-Jul-2019	CPI YoY	Jun	2.7%	2.7%	2.7%	⇨
	15-Jul-2019	Industrial Production YoY	Jun	5.2%	6.3%	5.0%	⇧
	15-Jul-2019	GDP YoY	2Q	6.20%	6.20%	6.40%	⇩
Japan	12-Jul-2019	Industrial Production YoY	May F	--	-2.10%	-1.80%	⇩

P* – Provisional Estimates F* - Final Estimates A* - Advanced Estimates T*- Third Estimates

COMMODITY

- Gold prices increased by 5.3% MoM in June vs. a contraction of 0.1% MoM in May amidst rising tensions between US-Iran and scheduled trade talks between US and China at the G20 summit. Dovish commentary by ECB, rising geopolitical tension in the Middle East and rising expectations of a Fed rate cut supported yellow metal demand.
- Brent prices contracted by 9.7% MoM in June vs. a contraction of 0.7% MoM in May amidst mounting tensions between US-Iran as US imposed new sanctions on Iran and as weak Chinese economic data fuelled concerns about global economic growth.

Domestic Market Macro Economics



India WPI Inflation

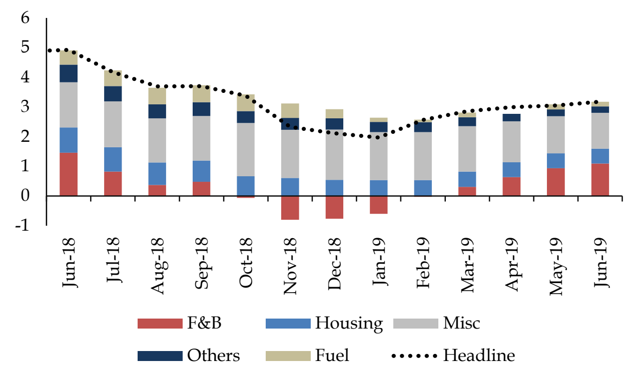
%YoY	Weights(%)	Mar-19	Apr-19	May-19
IIP	100	0.4	4.3	3.1
Sectoral Classification				
Mining	14.4	0.8	5.1	3.2
Manufacturing	77.6	0.1	4.0	2.5
Electricity	8.0	2.2	6.0	7.4
Use Based Classification				
Primary goods	34.0	2.6	5.1	2.5
Capital goods	8.2	-8.4	1.2	0.8
Intermediate goods	17.2	-2.5	1.9	0.6
Infrastructure/construction goods	12.3	6.4	7.2	5.5
Consumer durables	12.8	-3.1	2.2	-0.1
Consumer non-durables	15.3	1.0	5.9	7.7

May IIP

- Manufacturing PMI eased to 52.1 in Jun-19 from 52.7 in May-19 while service sector activity contracted in to 49.6 from 50.2 in May-19. As such, Composite PMI eased to 50.8 in Jun-19 from 51.7 in May-19.
- Core sector growth moderated to 5.2% YoY in May-19 from an upwardly revised 6.3% in Apr-19, as contraction in crude oil, refinery and fertilizer production more than offset robust expansion in steel and electricity production.
- Gross GST revenues for the month of June eased marginally to INR 999.4 bn (previous month: INR 1.0 trn). Nevertheless, it is higher than the revised FY20 required monthly run rate of ~INR 991 bn.
- India's industrial production moderated to 3.1% YoY in May-19 from an upwardly revised print of 4.3% in Apr-19 (earlier: 3.4% YoY). On sequential basis, the headline index improved by 4.5% MoM, which is slightly weaker than the average run rate of 5.6% seen in May over the last five years.
- India's merchandise trade deficit remained almost unchanged at USD 15.3 bn in Jun-19 vis-à-vis a deficit of USD 15.4 bn seen in May-19. Imports fell by 9.06% to USD 40.29 bn and exports fell by 9.71% to USD 25.01 bn. Gold imports came in at USD 2.69 bn.
- India's retail inflation increased to 3.18% YoY in June-19 from 3.05% in May-19. While the Jun-19 CPI inflation marks the second consecutive above 3.00% print, it however continues to remain well below RBI's medium term target of 4.0% for the eleventh successive month. The higher than expected increase in headline CPI inflation is partially offset by the moderation in core-core inflation (CPI ex Food, Fuel, and Precious Metals). The core-core inflation came in at 4.60% which marks the lowest print in nearly two years.

%YoY	May-18	Mar-19	Apr-19	May-19
Overall	4.0	4.8	6.3	5.2
Coal	12.0	9.1	3.2	1.8
Crude Oil	-2.9	-6.2	-6.8	-7.0
Natural Gas	-1.4	1.3	-0.7	0.0
Refinery Products	4.9	4.3	4.4	-1.5
Fertilizers	8.4	4.2	-4.4	-1.0
Steel	-0.1	6.7	19.0	19.8
Cement	13.0	15.8	2.3	2.8
Electricity	4.2	2.2	6.0	7.2

CORE Sector – Moderates from a 5 month high



India CPI Inflation

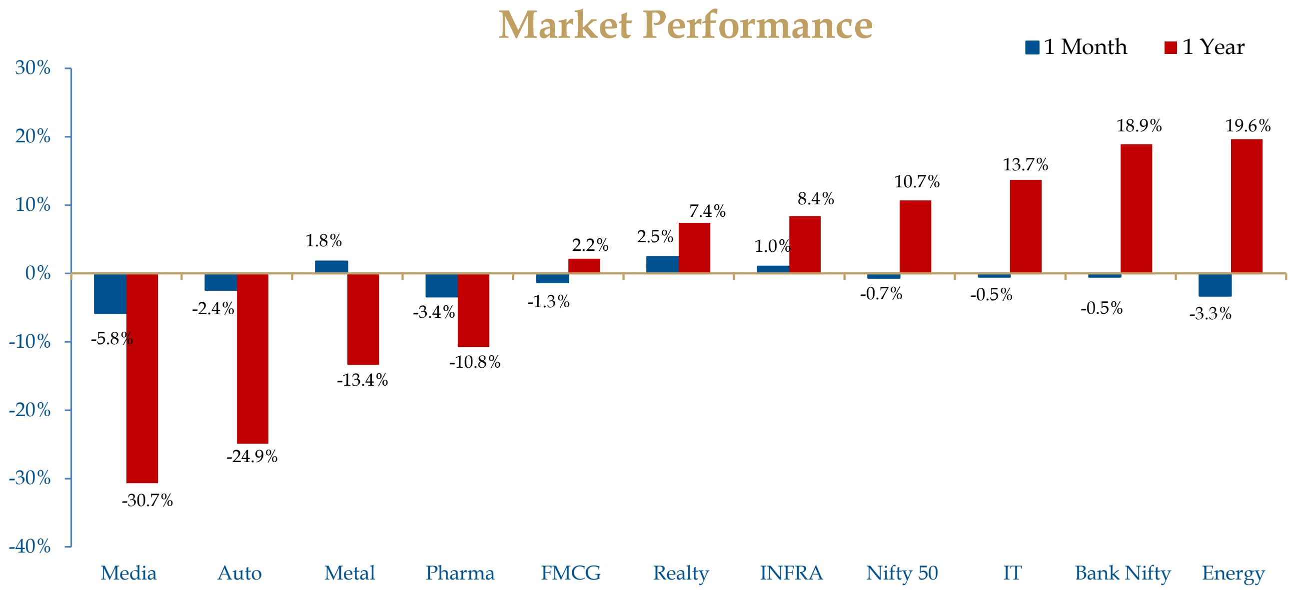
We expect:

- GDP growth to rise to 7.0% vs. 6.8% in FY19, with recovery to be back-loaded in H2FY20 as 1) Current consumption slowdown may prove to be cyclical, as support from direct income payout to farmers and increase in disposable incomes of urban households 2) Investment recovery to remain gradual and a function of NCLT resolution, anticipated moderation in real interest rates and provision of sufficient liquidity this year. Government' limited fiscal space may restrain pace of public capex.

- Inflation to average at 3.5% vs. 3.4% in FY19 on account of reversal of benign food inflation and moderation in core price pressures, assuming crude oil price stays at USD 65-70 per barrel.

Equity Market Insights

- Nifty has rallied by 9% YTD, in response to favorable election outcome and positive sentiments around emerging market equities in general. The revival in economic growth is likely to be gradual, given limited policy levers. Budget corroborates this view.
- Although we expect Nifty to inch up towards 13,000 in 2019, the market is consolidating. It is extremely difficult to find conviction ideas as only 4-5 large caps will drive index higher. The rally in Nifty to 13,000 will be driven by recent strong political mandate, accommodative RBI and measures to boost liquidity and availability of credit.
- Dovish global central banks amid slowing growth in developed world will also help capital flows to the emerging markets. Financial sector losses will reduce further as quarterly earnings unfold. Having said that, domestic concerns prevail in the form of NBFC crisis and indebtedness of Real Estate and Telecom Sectors.



Outlook & Expectations

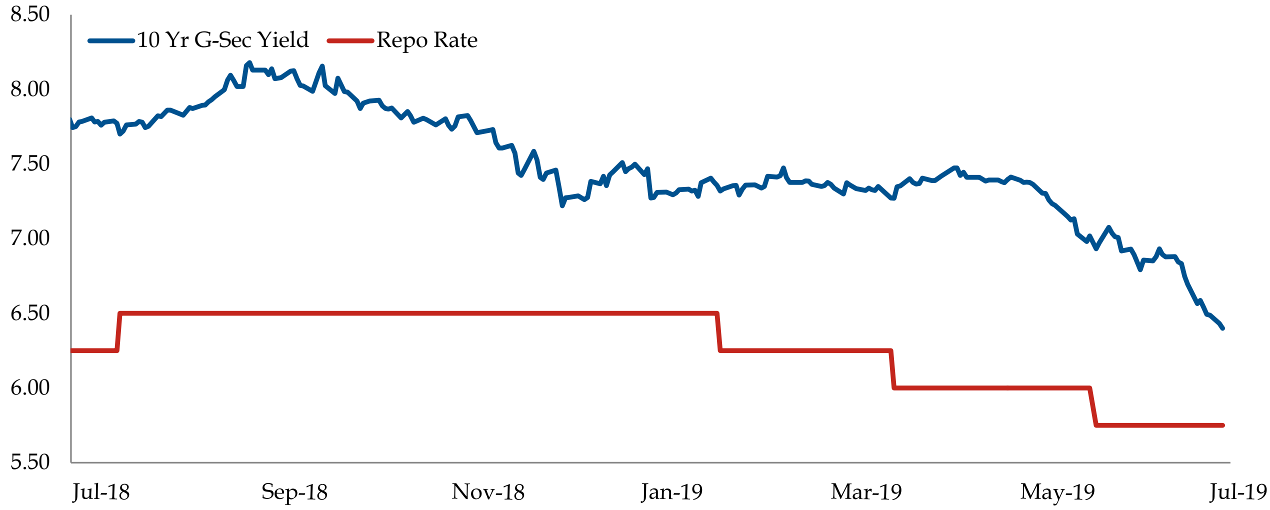
- Union Budget FY20 is a step in the right direction in terms of focus of this government. The positive surprise stems from realistic direct tax revenue projections, higher allocation for non-tax revenue and divestments even as expenditure stays broadly unchanged. The Budget lays emphasis on reviving rural demand and supplements it with sectoral incentives for Affordable Housing, MSMEs, Aviation, Roads, and Railways. Liquidity situation is partly addressed by capital infusion in Public Sector Banks. Bond yields have dropped sharply as fiscal deficit target for FY20 is retained. Government plans to borrow from overseas markets given the low external debt. Meanwhile, proposed higher public shareholding and higher tax on UHNIs has dented the sentiment in equities. However, it is hoped that rise in public shareholding will not go through or is hiked in a very gradual manner.
- We sense that the equity markets are transiently undergoing a consolidation phase since 2018, and it can last till initial 4-6 months of 2020. Though structural upside in equities is very much intact. As seen with market cycles historically, it could be the case that after a period of consolidation in indices, the second half of the Bull Run may offer much higher returns compared to the first half. Markets to witness consolidation phase this year and next market rally to begin from 2020.
- Earnings are poised to recover after a lost decade. We remain overweight on equities, with emphasis on large cap stock. Exposure to index funds and ETFs is also a good idea. In case of aggressive portfolios with 3-5 years

horizon, we recommend staggered investments in mid and small caps. On sectors, we favor infrastructure, capital goods, government capex-oriented stocks and financials.

Debt Market Insights

- The average systemic liquidity maintained a surplus of INR 539 bn in June from a deficit of INR 343 bn in May.
- The average 10yr G-sec bond yield moderated to 6.93% in June from 7.30% in May tracking moderation in US treasury yields. Alongside, 1) announcement of INR 125 bn OMO purchase, 2) lower oil prices, 3) US Federal Reserve signaling the likelihood of lower interest rates in the coming quarters, and 4) media reports of likelihood of Jalan Committee recommending close to INR 3 trillion transfer of RBI surplus capital to the central government also supported sentiment.
- We continue to expect headline CPI inflation to remain moderate at 3.5% in FY20 (3.4% in FY19). This would be the third consecutive year of below target inflation outturn for the Indian economy and is likely to continue to provide comfort to RBI's Monetary Policy Committee. We expect the RBI to opt for a 25 bps rate cut in the forthcoming policy review in Aug-19 after a rate cut of similar magnitude in June policy review. Possibility of additional easing could emerge in H2 FY20 if evolution of fiscal goes along expected lines and global financial market conditions remain broadly stable.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- Liquidity infusion in FY20 (so far) has come about via USD 5 bn FX swap and INR 525 bn OMO purchases. Going forward, we expect RBI to deploy both FX swaps and OMOs to infuse primary liquidity into the system - as per our estimates, the economy would need a cumulative of INR 1700 bn primary liquidity in FY20.
- Gross and net market borrowing is budgeted at INR 7100 bn (+24.3%) and INR 4731 bn (+11.9%) respectively in FY20. Adjusted for buybacks, the net supply of G-sec is expected to broadly remain unchanged around INR 4.2 trillion in FY19 and FY20. Budget makes INR 500 bn provision for buyback and switch of G-secs in FY20. The net SLR supply picture in FY20 could change from budgeted levels depending upon the extent of sovereign bond issuances. The government has indicated that it could test waters with 10-15% issuances via the sovereign bond route.
- We revise our G-sec trading range to 6.50-7.00% for the rest of FY20 from 6.75-7.25% earlier assuming incremental primary liquidity infusion of INR 800-900 bn.

Glossary

- **Consumer Price Index (CPI):** A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.
- **Wholesale Price Index (WPI):** An index that measures and tracks the changes in price of goods in the stages before the retail level.
- **Open Market Operations (OMO's):** is the buying and selling of government securities in the open market in order to expand or contract the amount of money in the banking system. Purchases inject money into the banking system and stimulate growth while sales of securities do the opposite.
- **Cash Management Bills (CMB):** A short-term security sold by RBI to meet any temporary shortfalls.
- **Purchasing Managers Index (PMI)** is based on surveys on private sector service /manufacturing companies. An index level of 50 denotes no change since the previous month, while a level above 50 signals an increase or improvement and below 50 indicates a decrease or deterioration.
- **Net Demand and Time Liabilities (NDTL):** It is the sum of demand and time liabilities (deposits) of banks with public and other banks wherein assets with other banks is subtracted to get net liability of other banks.
- **Current Account Deficit (CAD):** A measurement of a country's trade in which the value of goods and services it imports exceeds the value of goods and services it exports. A current account deficit represents negative net sales abroad. A country can reduce its current account deficit by increasing the value of its exports relative to the value of imports.
- **West Texas Intermediate (WTI):** also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content.

For Further Information on Model Portfolios, Kindly contact your Relationship Manager.

Radhika Piplani and Sanjana Shah
Economist
radhika.piplani@yesbank.in
sanjana.shah@yesbank.in

Shubhada M. Rao
Chief Economist
shubhada.rao@yesbank.in

Vineet Dhar
Group President and Head
Wealth & Channel Management
vineet.dhar@yesbank.in